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Texas Farmer Cooperative Principles

The Texas A&M University System

Texas Agricultural Extension Service

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TEXAS FARMER COOPERATIVE PRINCIPLES

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Farmer cooperatives are a unique form of business organization. This uniqueness results from: 1) their ownership by farmers, 2) the objectives for which they are created and 3) the principles by which they operate.

The uniqueness of cooperatives has led the U. S. Congress and many state legislatures to enact special laws which benefit cooperatives and their patrons. Legislation includes the Capper-Volstead Act, state incorporating statutes, special tax benefits and creation of the Farm Credit System. The Texas legislature provided separate incorporating statutes for cooperatives in the form of the "Co-operative Marketing Act."

This report identifies use and interpretation of cooperative principles by Texas agricultural cooperatives. To make this determination, a questionnaire was developed and mailed to Texas agricultural cooperatives in January 1981. Responses have been tabulated with the following results for each principle in the order of acceptance.

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Cooperative Principles

Cooperative principles originated in England with a group of weavers known as Rochdale pioneers. Although these principles were developed more than 100 years ago, they continue to be a valuable guide to cooperative uniqueness and success. These principles, briefly stated, are as follows:

1. Control should be democratic and in the hands of producers.
2. Net margin should be distributed on the basis of patronage.
3. Membership in the cooperative should be open and voluntary.
4. Ownership in cooperatives should be in proportion to patronage.
5. Return on capital investment should be limited.
6. Continuous membership education is needed.
7. Cooperatives should be politically neutral.
8. Cooperatives should not assume unusual risk.
9. Goods should be sold at regular retail prices.
10. Trading should be on a cash basis.

These principles have application to today's cooperatives under today's conditions. However, with the passage of time, adherence to these principles has eroded.

Principle 1. Control is democratic and in the hands of producers.

Democratic control means one-man, one-vote. This is the most commonly accepted principle among Texas cooperatives. Ninety-seven percent of the Texas cooperatives said they follow the democratic control principle.

One-member, one-vote is required by the Texas Cooperative Marketing Act in all Texas agricultural cooperatives except citrus. Some citrus cooperatives have chosen to vote in proportion to patronage. The Texas Cooperative Marketing Act reads, "No member of the association is allowed more than one vote because of the amount of stock or membership capital he may own therein, or that the association does not pay dividends on stock or membership capital in excess of eight per centum per annum."

Aside from the one-man, one-vote issue, a more subtle question involves who actually controls Texas cooperatives. When asked who controls their cooperative, 50 percent reported that members control cooperatives; 48 percent, the board of directors; and 2 percent, the management. One respondent said, "The board of directors controls the cooperative at all times except at the annual meeting."

Principle 2. Net margins are distributed on the basis of patronage.

Cooperatives operate on an at-cost basis. To accomplish this, all profits or net margins are distributed to members on the basis of patronage. This principle is easy to apply if all patrons are members, and all earnings are allocated to members each year. Cooperatives have increasingly taken on nonmember business. Such business has either been taxed with residual, "permanent" capital unallocated and remaining in the cooperative or distributed among the members. Either strategy represents a deviation from the cooperative service-at-cost principle.

Ninety-five percent of the Texas agricultural cooperatives reported they accept this principle. While nearly all cooperatives allocate savings or net margins to members each year, less than half (43 percent) allocate them to nonmembers. The most common practice for handling savings from nonmember business is to pay corporate income tax on that amount and hold the balance as "unallocated reserves" or "retained earnings." This becomes the cooperative's permanent capital. In a very few instances, the earnings from nonmember business are allocated to members on the basis of their business. In a few cases, the earnings are used to purchase replacements and repairs or put into an operating account.

The distribution of savings or net margins differs markedly among cooperatives. Eleven percent of the cooperatives reported that they paid out all savings or net margins in the form of cash. Thirty-five percent distributed the statutory minimum of 20 percent cash and 80 percent certificates of equity. One cooperative reported it distributed none as cash. The remainder (53 percent) distributed between 20 percent and 100 percent in the form of cash. (Table 1.)

Principle 3. Membership is open and voluntary.

Open membership has historically characterized most agricultural cooperatives. In recent years, some successful cooperatives, especially those with marketing agreements, have adopted closed membership policies. Other cooperatives with marketing agreements may close membership for only a certain portion of the year. Membership is closed when member volume is at or in excess of plant or facilities capacity or to maintain cooperative benefits for those who established the cooperative. Eighty percent of the Texas agricultural cooperatives identified open membership as an integral part of their operating policy.

Ninety-three percent of the Texas cooperatives accept new members 12 months out of the year. Of those who do not, membership usually is opened 2 or 3 months of the year.

Membership eligibility is another aspect of membership policy. Five out of six Texas cooperatives have a formal policy adopted by the board of directors as to who may be a member. The policy usually reads that, "The member must be an active producer of agricultural products and in good standing with a cooperative." The term "good standing" generally means the producer has done business with the cooperative during the past 2 years. Some cooperatives require the member to accumulate $10 per year net savings on the business done with the cooperative. One cooperative had the requirement that a member must gin

Table 1. Cash distribution of annual savings or net margins by Texas agriculture cooperatives, 1980.

Percent Paid as Cash	Percent of Cooperatives Responding
100	11
50-99	22
20-49	31
20	35
0	1

more than 50 percent of his cotton crop with the cooperative or must purchase $5,000 worth of farm supplies with the cooperative during the year. The board usually reviews each membership application on an individual basis.

Eighty-one percent of the cooperatives responding restrict membership to farmers; 19 percent allow nonfarmers to become members. Cooperative restriction of membership to farmers is particularly important in marketing cooperatives. For a marketing cooperative to enjoy Capper-Volstead exemption from antitrust prosecution, all members must be farmers.

Principle 4. Ownership in cooperatives is in proportion to patronage.

The principle of ownership in proportion to patronage, perhaps more than any other, distinguishes cooperatives from their corporate counterparts. This principle recognizes that those who patronize the cooperatives own it. Ownership in proportion to patronage is accomplished and maintained by:

- Allocating net margins on the basis of patronage and retaining them in the business for a period of time;
- Revolving out allocated net margins on a regular basis and in a relatively short time frame;
- Retiring the capital of estates.

A recent national survey shows that 29 percent of cooperatives in the United States have no equity redemption plan. Only 39 percent of the cooperatives allow families to get their investment capital out if farmers die. The key to this principle is reflected in the extent to which all net margins are allocated; equities are regularly revolved, and deceased or retired members hold equity certificates in the cooperative.

Seventy-two percent of the Texas cooperatives accept ownership in proportion to patronage principle in their operations. However, an analysis of equity handling shows a slightly different picture. Half of the Texas cooperatives have a formal policy for equity redemption. The most frequent basis for equity redemption is a revolving plan followed by policies to redeem paper upon retirement or death. Only 40 percent of the cooperatives have a revolving plan. Half of those with a revolving plan revolve in 10 years or less; the other half in more than 10 years.

Forty percent of Texas cooperatives have a policy of redeeming stock or equity certificates of estates. Thirty-two percent of Texas cooperatives have never redeemed preferred stock or equity certificates. In this regard, Texas cooperatives are a little below the national average.

An increasing development among Texas cooperatives is not to allocate all of the savings or net margins to members on the basis of patronage. This is reflected in the percentage of the cooperative's net worth allocated to members. The study shows that 57 percent of the cooperatives have some part of the net worth unallocated to members. Forty-three percent of the cooperatives have allocated 100 percent of their net worth to members.

Table 2. Equity allocation by Texas agricultural cooperatives, 1980.

Percent of Equity Allocated	Percent of Cooperatives Responding
100	43
90-99	19
50-89	19
1-49	13
0	6

In one of four Texas cooperatives, someone other than a member or patron owns equity interest in the cooperative. Most of those are retired farmers or heirs of deceased members who own preferred stock, book credits or other forms of patronage equity certificates.

About half of the cooperatives allow equity holders to buy and sell their equity certificates, usually with only the approval of the board of directors.

Principle 5. Return on capital stock is limited.

The limited return principle recognizes that cooperatives are established to benefit producers as patrons, not as investors. By limiting returns on investment, greater rewards can be allocated for patronage. In contrast with the corporate business world, there is a growing tendency among cooperatives to obtain capital from other than savings or retains.

Eighty-one percent of the Texas cooperatives pay no dividends on preferred stock or other equity certificates. Those that do, generally pay a rate of dividend at 8 percent or below. Three percent of the cooperatives pay dividends on 100 percent of their equity certificates.

Because of high interest rates, some cooperatives have turned to selling certificates of indebtedness or bonds to their members in addition to allocating net margin. Ten percent of the Texas cooperatives surveyed sell bonds or other certificates of indebtedness to their members. One cooperative reported certificates of indebtedness of 2-year duration that paid an interest rate 1.0 percent below the average charged by the Texas Bank of Cooperatives. It also sold 5-year certificates of indebtedness with the same interest rate charged by the Texas Bank of Cooperatives, and 10-year certificates at an interest rate 1 percent above the average rate charged by the Texas Bank of Cooperatives.

Principle 6. The cooperative provides continuous education.

Member education is an often forgotten principle of cooperatives. Turnover in cooperative membership makes a continuous cooperative education program essential. Unfortunately, only one in three Texas agricultural cooperatives conducted educational programs during 1980. Technical skills are needed to operate an efficient business with competent employees, directors and management. Education is needed to establish greater understanding by members of the cooperative way of conducting business. The cooperative idea can deteriorate rapidly without using re-education of old members as well as new members.

Table 3. Expenditures by Texas cooperatives on educational activities, 1980.

Amount Spent	Percent of Cooperatives
$2,000 or more	17
$1-$1,999	19
0	64
Total	100

Twenty-seven percent of Texas cooperatives in 1980 sponsored an educational program for the membership. Of those who held an educational program, nearly half held only one program during the year. One-fourth of them held two during the year. The remaining one-fourth reported from three to 50 educational events. The one conducting 50 was a regional cooperative with many locals affiliated with it. Among locals, the greatest number of educational programs held during the year was seven.

Cooperative expenditures on educational activities were very low (Table 3). Only 17 percent of the cooperatives spent more than $2,000 on member education; nineteen percent spent $1 to $1,999; 64 percent spent nothing on member education. Without increasing expenditures on member education, cooperatives in Texas cannot be expected to grow and survive.

Subjects taught were about equally divided between three general areas: 1) improving the members' production practices, 2) telling the cooperative story and 3) improving technical skills of the cooperative staff. The subjects most frequently were taught by a member of the Farmland Industries' staff, followed by the general manager and Texas A&M University staff. Other trainers included board members, other regional cooperatives' personnel, trade association personnel, bank personnel, salesmen, etc. About half of the educational events were held in conjunction with the regional cooperative. One-fourth of them involved Texas A&M University personnel, frequently staff members of the Texas Agricultural Extension Service.

Principle 7. Cooperatives are politically neutral.

Political neutrality means not becoming identified with particular parties or candidates. Politics do play a role in cooperative success. That political role is most effective if support is tied to the "cooperative cause" and specific issues rather than to a political party.

Nine out of 10 Texas agricultural cooperatives identified themselves as politically neutral. Eighty percent of the Texas agricultural cooperatives reported that they do not engage in any form of political action. Most of the other 20 percent reported that they do not collect funds from members for that purpose.

Those that collect funds for political action do so as a separate fund known as a PAC fund (Political Action Committee). The PAC need not be the responsibility of the board of directors.

Principle 8. Cooperatives do not assume unusual risk.

Cooperatives cannot afford to speculate or gamble with the producers' money. Yet the cooperatives must bear a large share of the burden for the economic welfare of the producer. This requires that the cooperative be technologically and economically competitive. With increasing capital requirements, interest rates and price instability, the future success in agriculture is essentially one of risk management. Risk should be assumed by cooperatives with a clear knowledge of both management and the board, following a detailed feasibility study.

The survey showed that 78 percent of the Texas cooperatives accept this principle. Major expansion was undertaken by 56 percent of the Texas cooperatives during the past 5 years. Most of the expansion was to update machinery or expand present business lines. This included building new elevators, remodeling cotton gins (especially to adapt to modulization), expanding fertilizer businesses by adding anhydrous ammonia, expanding farm supply businesses and adding more warehouse storage. Approximately two-thirds of the expansion involved remodeling or updating existing facilities and machinery and one-third involved adding new lines of business. New lines of business included fertilizer, anhydrous ammonia, fuel, feedmills, hardware stores, grain elevators and computer systems.

Most common reasons given for expansion included: "needed," "to better serve the member," "to increase volume," "to update obsolete equipment for which there are no repair parts available," or "to reduce labor costs."

Sixty-five percent of the expansions undertaken were preceded by feasibility studies. Most frequently, the managers and selected directors conducted the feasibility studies. Next in frequency, the feasibility study was conducted by either the board of directors or the manager. Only 10 percent of the cooperatives that undertook major expansion utilized outside specialists to make the feasibility study. Half of the studies made by outsiders were by Farmland Industries.

When asked about the future plans, 23 percent of the cooperatives reported that they contemplated major expansion during the next 2 years. Primary decision-making about future expansion was recognized by the board of directors. In one-third of these decisions, management was involved with the board in making the decisions and, in one-third, the members were involved with the board in making the decisions. In the other third, the board of directors made the decision, presumably on their own.

Eighty-two percent reported that the cooperative protected the value of inventory. The most frequent method of protecting the value of inventory was insurance. The next most frequent methods were hedging and forward selling. Also mentioned were security, auditing, pricing policy, inventory control and not overbuying. Most frequently the general manager was listed as being responsible for protecting the value of inventory. To a lesser degree, the manager and the board of directors were jointly responsible.

Principle 9. Farm supplies are sold at regular retail prices.

This principle suggests that farm supplies be priced according to prevailing market levels. A farmer thus is assured of paying or receiving a price which is competitive. Fifty-six percent of Texas cooperatives reporting adhered to the principle that farm supplies be sold at regular retail prices. Forty-six percent reported a formal pricing relative to competition.

The majority of the cooperatives try to "price with" or "stay with" the competition. The next most common practice is to price at a certain percentage above cost. This usually results in a competitive price. Others expressed their pricing policy as: 1) price at or below competition; 2) stay between the competition; 3) keep price as low as possible to stay in business; or 4) set margin at least at the breakeven point.

Ninety-one percent reported that all members pay the same price. Reasons for discounts included volume purchased, direct shipment, less handling and differences in cost of services.

Cooperatives differ widely in how they price grain to members. The most common method begins with the price quotation from a regional or an export elevator, minus freight charges and margins. Most grain cooperatives expressed their pricing policy as meeting the cash or open market price, meeting competition or being priced the day received. Margins are set as a percentage of the selling price or as a fixed-cents-per-bushel or hundredweight.

Although the majority reported pricing at regular retail prices, only about 10 percent viewed their competition as playing a major role in pricing of products they had to sell.

Principle 10. Trading is on a cash basis.

On the surface, this may appear impractical in a world which operates on credit. However, 47 percent of Texas cooperatives operate by this principle. The critical point is that the cooperative is not a bank. With higher interest rates and increased economic risk involved in business, cooperatives must clearly state their credit policy. A closer working relationship is needed between cooperative credit institutions, regional marketing cooperatives and regional supply cooperatives.

In the survey, 69 percent of all cooperatives reported having a formal credit policy regarding member business. Half of the cooperatives having a credit policy revised it within the last year because of increasing interest rates. Sixty percent revised their policy within the last 2 years. Those not revising their policy recently may have policies which traditionally have been stringently stated and successfully operated.

The revisions have resulted in a more strict credit policy. For example, credit frequently was reduced from 60 days to 30 days. In some cases, the 30-day credit was cut out and cash trading was expected on fertilizer, feed, seed and chemicals. In other instances, a maximum credit limit was set, such as $5,000 per account. Cooperatives also are beginning to apply a credit charge, such as 10 percent, on all outstanding accounts receivable. In one instance, the interest charge was increased from 10 to 18 percent. Legal actions are increasingly being taken against old accounts.

Surprisingly, some cooperatives did operate strictly on a cash basis. In fact, 11 percent reported 100 percent of farmer supply business is on a cash basis. However, credit is still the lion's share of a cooperative's business. Two-thirds of the cooperatives reported conducting more than 50 percent of their business on credit (Table 4).

Table 4. Percent of farm supply business conducted in cash by Texas cooperatives, 1980.

Percent Business Conducted in Cash	Percent of Cooperatives Responding
100	11
50-99	7
10-49	42
1-9	24
0	16

Old accounts are troublesome. Nineteen percent of the cooperatives responded that 20 percent or more of their accounts receivable were more than 120 days old (Table 5).

However, many cooperatives keep their accounts receivable current. Twenty-five percent of the cooperatives have no accounts more than 120 days old.

Table 5. Percent of accounts receivable in excess of 120 days, Texas cooperatives, 1980.

Percent of Accounts Receivable Older Than 120 Days	Percent of Cooperatives Responding
20 or more	19
10-19	15
1-9	41
0	25

Of more concern was the number of cooperatives having accounts receivable that are more than a year old (Table 6). A majority of the cooperatives had at least one account that was more than a year old. Eleven percent of the cooperatives had more than 10 percent of their accounts receivable more than a year old. Such cooperatives are performing highly risky banking functions for which they are neither authorized nor qualified! Such accounts should have been transferred to credit institutions long ago.

Only 6 percent of the cooperatives reported a formal arrangement or understanding with the local credit institutions for extension of credit to producer members who trade with them. The most common arrangements are with local banks, followed by the PCA's. In these instances, when accounts receivable reach a certain age, the general manager calls the bank with which the member does business and arranges for payment of the account. There is, of course, a prior understanding with the member regarding this action.

Table 6. Percent of accounts receivable more than 1 year old, Texas cooperatives, 1980.

Percent of Accounts Receivable More Than 1 Year Old	Percent of Cooperatives Responding
10 or more	11
5-9	19
1-4	28
0	42

Problems Facing Texas Agricultural Cooperatives

The cooperatives responding listed the following as the greatest problems they face, in the order of frequency: high interest rate; skilled labor shortage; declining agricultural market; competition from corporate businesses; lack of member business; too few members; outdated equipment and facilities; inability to generate sufficient savings; and competition from other cooperatives.

Other problems facing cooperatives identified in the survey were: harsh impact of inflation; impact of regulations, especially OSHA; drought; agricultural lands moving out of production (urban sprawl); insufficient equity investment; poor borrowing capabilities; high taxes; unpredictable cash flow; large inventories; and instability in the grain market.

Interestingly, few of these problems relate directly to cooperative principles. Some, such as low membership and volume of business, could be a result of the fact that producers in the area look upon them as "just another business." Perhaps it is time for Texas cooperative managers, directors and members to step back and think about how they are unique. Such an analysis, with appropriate action, might overcome many of the problems confronting cooperatives and put them back on a growth track.

Implications

Cooperatives are viewed by the government as unique business entities in agriculture. Their unique differences from regular business corporations are represented by several principles that have characterized cooperatives for more than a century and continue to prevail today. The purpose of this survey was to identify the extent to which Texas agricultural cooperatives adhere to long-standing cooperative principles.

Texas agricultural cooperatives are unique in several ways:

- One-man, one-vote remains the basis of producer control.
- There is a strong cooperative conscience—a clear image of what agricultural cooperatives should be.
- Limited return on capital continues to ensure that the benefits of cooperation go to the patrons.
- Texas cooperatives continue to willingly identify themselves as cooperatives.

Some erosion appears in uniqueness and adherence to cooperative principals.

1. Most disturbing is that ownership in Texas agricultural cooperatives, with few exceptions, is not proportional to patronage. Too much of the cooperative equity (ownership) capital is held by former members or estates of deceased members. The practice of "freezing" old equity capital (usually held by retired or deceased past members) and declaring such equity certificates ineligible for redemption is a clear violation of the principle that ownership be proportional to patronage.

   Another emerging practice is to lump together all equity capital holdings of individual members. Age of ownership is lost in this process. This clearly violates the "first-in, "first-out" principle and retards the adjustment of ownership to patronage.

Half of the Texas cooperatives did not have a formal policy for equity redemption, and nearly one in three has never redeemed preferred stock or equity certificates.

Several dangers exist in having the cooperative ownership and active members separated:

- Reduced realization of responsibility exists among current members for financing their cooperative's business.
- The manager is less accountable to current membership.
- Indifference can develop among current members for a business that is a vital adjunct to the members' farm business.
- Uncertainty is created among current members as to the value of equity owned in the cooperative.
- Less realization of the cost of capital is likely to develop among cooperative decision makers.
- Inflation erodes the value of past members' equity investments to the point that present value approaches zero.

2. Another alarming trend is insufficient member involvement in policy formulation. While members delegate policy responsibilities to the board of directors, responsibility exists for the board to regularly report to and consult with fellow members regarding issues before board meetings. One way to involve members in policy decisionmaking is to assign them to various committees of the board of directors. The policy decisions made by the board of directors should be reviewed and evaluated by the membership in annual meetings. Pending policy decisions also should be discussed to develop a sense of desired member direction.

3. There is a trend toward permanent capital accumulation by Texas cooperatives. The most common source of permanent capital is savings on nonmember business on which the cooperative pays a corporate income tax and retains as unallocated reserves. The majority of Texas agricultural cooperatives have some part of the net worth allocated to members. Only 43 percent of the cooperatives surveyed allocated all of the net margin to members. This trend, if it continues, results in a fund of capital retained in the name of the cooperative, preventing

the flow of benefits (profits or savings) to the patron-member. It also tends to sever the link between membership and control.

In a private corporation, the customer is the means for profit. In a cooperative, the member-patron is both the means and the recipient of profit. If cooperatives continue to build permanent capital, the patron eventually will view cooperatives as just another business. Permanent capital held by and in the name of the cooperative encourages present members to call for liquidation of the business to divide up the unallocated reserves. In addition, management responsibility increasingly becomes separated from membership responsibility.

4. Another weakness is the extent of overdue accounts receivable. High interest rates increase the tendency by patrons to use the cooperative as a credit source. Most cooperatives charge interest rates on overdue accounts well below the prevailing bank rates.

   With nearly one-fifth of the cooperatives with accounts receivable more than 120 days old and about one-tenth with accounts more than 1 year old, Texas agricultural cooperatives do experience increasing cash flow difficulties. This weakens their financial structure, increases the cost of conducting business and stymies growth.

   While trading on a cash basis is a difficult principle for Texas cooperatives to achieve, extensive overdue accounts receivable are sheer business folly.

5. The last disturbing finding from this study was that only about one in five Texas cooperatives sponsored or held educational programs for the membership during 1980. Also disturbing is the small amount of funds spent on education.

   Members need to understand the unique features of cooperatives for them to be perpetuated. Members need to know the good and bad features of their cooperative—what it is, how it functions, the problems, the alternatives and the likely costs and benefits of cooperative membership. Members must be informed. Adequate funds must be allocated to conduct needed educational programs. Membership education is a prerequisite to the survival of agricultural cooperatives.

Texas agricultural cooperatives face challenges.

1. The annual meeting should truly be an informative experience with members being advised of the decisions of the board of directors and given an opportunity to evaluate them.

2. Cooperatives should develop and adhere to an active equity retirement plan, with the oldest certificates redeemed first.

3. All net margins or savings should be allocated to members each year on the basis of patronage.

4. Cooperatives should have a firm but fair credit policy to prevent overdue accounts receivable. Such a policy might include a close working relationship with other local credit institutions such as Production Credit Associations and banks.

5. Cooperatives should develop and fund an extensive member education program. Such a program should extend beyond the board of directors and staff to the full membership.

Educational programs conducted by the Texas Agricultural Extension Service serve people of all ages regardless of socioeconomic level, race, color, sex, religion or national origin.

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